AGENDA — June 29, 1999 Business Taxes Committee Meeting

Regulation 1532, Teleproduction or Other Postproduction Service Equipment

ACTION 1 – Consent Items

Item	Comments
1. Exhibit 1. Page 2. "Primarily"	Industry has agreed with staff's proposal that "tangible personal property" be included as defined by statute.
2. Exhibit 1. Page 2. "Qualified Person"	Staff has agreed to industry's proposal to include services referenced in statute that are not included in NAICS section 512191.
3. Exhibit 1. Pages 2-3. "Primarily Engaged"	Industry and staff have agreed to language to define "primarily engaged."
4. Exhibit 1. Page 3. "Establishment"	Industry and staff have agreed to language to define "establishment."
5. Exhibit 1. Page 4. "Teleproduction or Other Postproduction Services"	Staff has agreed to industry's proposal to include animation in the definition of "teleproduction or other postproduction services."
6. Exhibit 1. Page 4. "Teleproduction or Other Postproduction Services"	Industry and staff have agreed to not include "video games" in services specifically excluded from the definition of "teleproduction or other postproduction services."
7. Exhibit 1. Page 4. "Teleproduction or Other Postproduction Services"	Staff has agreed to industry's proposal to include digital multimedia formats in addition to film or video as defined by statute.
8. Exhibit 1. Page 5. "Teleproduction or Other Postproduction Services"	Industry and staff have agreed to language to include creating "models and miniatures" in the definition of qualifying services.
9. Exhibit 1. Page 5. "Teleproduction or Other Postproduction Services"	Industry and staff have agreed to language to include "synchronous sound recordings" in the definition of qualifying services.
10. Exhibit 1. Page 5. "Teleproduction or Other Postproduction Services"	Staff has agreed to industry's proposal to incorporate a list of specific services and their technical definitions in the regulation.
11. Exhibit 1. Page 6. "Teleproduction or Other Postproduction Services"	Staff and industry have agreed to language to incorporate the providing of facilities and specialized equipment in cases where the furnishing of the property does not constitute a lease.
12. Exhibit 1. Page 6. "Tangible Personal Property"	Staff and industry agreed not to include customized vehicles in the definition of tangible personal property as previously proposed by industry.
13. Exhibit 1. Page 6. "Tangible Personal Property"	Staff has agreed not to include provisions similar to those found in Regulation 1525.2 regarding minimum dollar thresholds for purchases and a requirement that property purchased be depreciated for income tax purposes.

Regulation 1532, Teleproduction or Other Postproduction Service Equipment

Item	Comments
14. Exhibit 1. Page 7. "Tangible Personal Property"	Industry and staff have agreed to language to include custom consoles and equipment racks.
15. Exhibit 1. Page 7. "Tangible Personal Property"	Industry and staff have agreed to language to include materials (under certain circumstances) and fixtures purchased as tangible personal property in the definition of "tangible personal property."
16. Exhibit 1. Page 7. "Tangible Personal Property"	Industry has agreed with staff's position that ergonomic chairs do not qualify as tangible personal property.
17. Exhibit 1. Page 8. "Exemption Certificates."	Industry and staff have agreed to language with respect to the requirement that a retailer accept a certificate in a timely manner.
18. Exhibit 1. Page 9. "Exemption Certificates."	Staff has incorporated industry's request that language be added to allow for blanket certificates.
19. Exhibit 1. Page 11. "Exemption Certificates."	Industry and staff have agreed to language to reflect that the tax is due at the time the property is converted from an exempt use, not the time of purchase.
20. Exhibit 1. Page 12. "Conversion of Property"	Staff has incorporated language proposed by industry to reflect that a sale or lease to a qualified person is not a conversion.
21. Exhibit 1. Page 12. "Conversion of Property"	Staff and industry have agreed on clarifying language that payment of the partial tax is an election to pay tax on cost, even if there is a subsequent conversion of the property.
22. Exhibit 1. Pages 13-14. "Leases"	Industry and staff have agreed to language regarding leases by a qualified person, and leases to a qualified person.

ACTION 2 – Authorization to Publish

Direct the publication of the proposed Regulation 1532 as adopted in the above action.

FORMAL ISSUE PAPER

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

Issue Paper Number 99-027

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Technology & Administration Committee
- ☐ Other

BOARD OF EQUALIZATION
KEY AGENCY ISSUE

REGULATION 1532, TELEPRODUCTION OR OTHER POSTPRODUCTION SERVICE EQUIPMENT

I. Issue

As a result of the enactment of section 6378 of the Revenue and Taxation Code, which is operative January 1, 1999 and provides for a partial exemption of certain teleproduction or other postproduction service equipment, staff has prepared a proposed Sales and Use Tax Regulation 1532, to implement and clarify this new partial exemption.

II. Staff Recommendation

Adopt proposed regulatory language as agreed upon by staff and industry.

III. Other Alternative(s) Considered

None

IV. Background

Operative January 1, 1999, Revenue and Taxation Code section 6378 was added under the provisions of Assembly Bill 2798, Chapter 323, Statutes of 1998. This section provides an exemption from the 5 percent state sales and use tax on purchases of tangible personal property by qualified persons to be used primarily in teleproduction or other postproduction services as described in Code 512191 of the North American Industrial Classification System Manual (NAICS). The exemption also extends to tangible personal property purchased for use by qualified persons to be used primarily to maintain, repair, measure, or test any property described in the preceding sentence, together with all repair and replacement parts.

Revenue and Taxation Code section 6378 was substantially modeled after the partial exemption for manufacturing equipment in section 6377 which is interpreted in Regulations 1525.2, "Manufacturing Equipment" and 1525.3, "Manufacturing Equipment-Leases of Tangible Personal Property." For this reason, staff had originally proposed that many of the provisions of Regulation 1525.2 be used as guiding principles in drafting Regulation 1532. In many respects, section 6378 is a narrower exemption because it applies only to a small number of highly specialized entities that provide postproduction services to the movie industry. However, unlike the manufacturing equipment exemption, a qualified person under section 6378 does not have to be a new trade or business.

Industry's original intent to parallel the two partial exemptions provided by sections 6377 and 6378 is evident by a letter submitted by the primary sponsor of section 6378, the International Teleproduction Society (ITS). In a letter dated November 19, 1998 (Exhibit A) to the Board's Executive Director, Mr. Chris Micheli, an attorney for ITS, requested that the Board immediately begin a regulatory project for this statute and stated the following:

> "As we patterned the postproduction partial exemption after the partial exemption for start-up manufacturers contained in CRTC § 6377, I believe that SBE Regulation 1525.2 would serve as an appropriate guide for developing a regulation to implement CRTC § 6378."

Additionally, in a background paper prepared by Mr. Micheli, he stated: "This statute is based largely on the partial exemption for manufacturing equipment found in CRTC § 6377."

The two statutes contain the following similar or identical provisions:

(1) Both statutes apply only to a sale to, or use by, a qualified person of either tangible personal property used for specified purposes or to “tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test” such property. [Rev. & Tax. Code §§ 6377(a)(1) and (3) and 6378(a)(1) and (2).]
(2) Neither exemption applies to tangible personal property that is used primarily in administration, general management, or marketing or to furniture, inventory, or equipment used to store products. [Rev. & Tax. Code §§ 6377(a) and (b)(10)(B) and 6378(b) and (c)(5)].
(3) Both exemptions are lost if the property is removed from California or converted to a nonexempt purpose within one year of purchase. [Rev. & Tax. Code §§ 6377(e)(1) and (f) and 6378(e)(3) and (f)].

Staff originally believed that section 6378 was meant to apply to only a limited number of specialty firms providing teleproduction or other postproduction services. There is nothing in the legislative history or the statute itself that suggests that this exemption was intended to apply to major production companies or other companies in which postproduction services were not their primary business.

When the legislation for this exemption was first introduced, there was disagreement over the amount of revenue loss the exemption would create. The Board’s initial analysis was that the annual loss would be about $27 million. However, the sponsors of the bill provided data to support a much lower revenue loss. The Bill Analysis for the May 13, 1998 hearing by the Assembly Committee on Appropriations states:

> “Based on industry survey data, there are 200 full-service, independent postproduction facilities in California accounting for about $100 million in capital purchases annually. Consequently, the annual General Fund revenue loss based on this information would be in the range of $5 million.”

Discussion

The following is a summary of the primary areas of disagreement regarding the implementation of the regulatory language prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff and industry representatives have resolved all issues.

A. <u>"Teleproduction" - Regulation 1532(a)(1)</u>

Section 6378 defines "teleproduction or other postproduction services" as services for film or video that include editing, film and video transfers, transcoding, dubbing, subtitling, credits, closed captioning, audio production, special effects (visual or sound), graphics or animation.

An industry representative suggested that the term "teleproduction" was intended to include all activities related to production for television. Therefore, they contend that all persons primarily engaged in such a business and who purchase assets for television production, qualify for the exemption as long as such assets are used in postproduction services.

It is staff's position that this partial exemption was not intended to apply to this portion of the industry. Staff believes that the use of the word *other* in the term "teleproduction or other postproduction services" means that teleproduction services are a type of postproduction service. Furthermore, North American Industrial Classification System (NAICS) Code 512191 includes only those persons primarily engaged in postproduction services. Additionally, sections 6378(a)(1) and (2) state that the exemption applies to tangible personal property "used primarily in teleproduction or other postproduction services." Therefore, the partial exemption does not apply unless the purchaser claiming the exemption is primarily engaged in postproduction services and uses the property primarily in postproduction services.

This was an issue that was thought to be in disagreement prior to the meeting of interested parties on May 26, 1999. However at that meeting industry indicated there was no disagreement on this matter.

<u>B. "Qualified Person" - Regulation 1532(c)(2)</u>

Section 6378 has several conditions that must be met before the exemption applies. Two of these conditions are that the person claiming the exemption must be a "qualified person" and that the property will be primarily used for teleproduction or other postproduction services. An issue has arisen because these two conditions do not completely overlap. Industry's position is that it was the intent of the Legislature to include persons primarily engaged in any postproduction audio services as qualified persons. Staff believes that this interpretation is not consistent with the statute.

Section 6378(c)(2) defines a "qualified person" as "any person whose line of business is primarily engaged in teleproduction or other postproduction activities described in Code 512191 of the North American Industrial Classification System Manual published by the United States Office of Management and Budget, 1997 edition."

Code 512191 defines this industry as follows:

> "This U.S. Industry comprises establishments primarily engaged in providing specialized motion picture or video postproduction services, such as editing, film/tape transfers, subtitling, credits, closed captioning, and animation and special effects."

NAICS Code 512191 does not include postproduction audio services for film, television, and video productions. Rather, such audio services are classified in NAICS Code 512240, *Sound Recording Studios*. However, the definition of "teleproduction or other postproduction services" in section 6378(c)(3) (which applies to the use of the property) includes "audio production" and "special effects (visual and sound)."

To determine whether a person is "primarily engaged" in teleproduction or other postproduction activities, staff proposed a percentage of gross revenues test as follows: A person may receive the exemption for audio equipment used primarily in postproduction services only if that person's line of business derives 50 percent or more of its revenue from the services set forth in NAICS Code 512191 (which do not include postproduction audio services). For example, a person who receives 90 percent of its gross revenues from activities described in NAICS Code 512191 and 10 percent of its gross revenues from postproduction audio services could obtain the exemption on audio equipment purchased for postproduction audio services. However, if these percentages were reversed, the person would not be a qualified person who is eligible for the exemption.

Industry's proposed language provides that a "qualified person" includes any person "[w]hose purchase of tangible personal property is used primarily in providing teleproduction or other postproduction [services]." Language provided by industry permits any entity that purchases tangible personal property and uses it for teleproduction or other postproduction services to be a qualified person. Staff believes this is inconsistent with the statute which includes *two* main requirements. First, the person purchasing the property must be a qualified person. Second, the property must be primarily used for specific services.

Industry also disagreed with staff's proposed definition of "primarily engaged" as "50 percent or more of gross revenues derived from teleproduction or other postproduction activities for the one year period following the date of purchase of the property." Industry believes the use of a "gross revenue" test is arbitrary, unreasonable and not anticipated or intended by the statute.

Staff believes that this definition is a fair and reasonable interpretation of the term “primarily engaged.” The 50 percent or more threshold is the same threshold percentage used in determining if property is “primarily” used in providing teleproduction or other postproduction services. Such a test provides a means of ensuring a fair and uniform interpretation of the statute.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff and industry have agreed upon language. Industry has agreed to accept staff’s proposed language to include a 50 percent gross revenue test and staff has agreed to industry’s broader interpretation of the definition of an establishment. Staff also agreed to include audio services that are performed postproduction in the definition of services that are included in the definition of a qualified person. While these services are not included in NAICS code 512191, they are specifically included in the statute as a qualified service.

C. “Video Games” - Regulation 1532(c)(2)

Staff had proposed language to specifically exclude persons who produce video games from the definition of a qualified person. Once staff agreed with industry that animation is a qualifying service, staff was concerned that persons engaged in animation for the purpose of producing video games would claim the exemption.

While staff and industry representatives are in agreement that producers of video games were not intended to benefit from this exemption, a satisfactory definition of what constitutes a video game could not be agreed upon. While industry is not advocating the inclusion of producers of video games in the definition of a “qualified person,” they object to their specific exclusion due to concerns that staff may interpret interactive motion pictures to be classified as video games. Since a clear definition of “video games” could not be agreed upon, staff elected to remove language that specifically excluded persons who produce video games from the definition of a “qualified person.”

D. “Establishment” - Regulation 1532(c)(2)(C)

The partial exemption provided under section 6378 applies only to sales to, or the use by, a “qualified person” which means “any person that is primarily engaged in teleproduction or other postproduction activities...” A “person” includes “any individual, firm, partnership, joint venture, limited liability company...corporation...” (Rev. & Tax. Code § 6006). Staff believes the literal interpretation of sections 6378 and 6006 is that the term "qualified person" applies to the entire entity, such as a corporation, and that the entire entity must be "primarily engaged" in teleproduction or other postproduction activities in order to qualify for the exemption. However, staff believes that this exemption is meant to be interpreted and applied, where possible, in the same manner as the manufacturing equipment exemption. Accordingly, staff believes that using the more liberal interpretation provided in the manufacturing equipment exemption by applying the "primarily engaged" test to an "establishment" will more accurately reflect the intent of the Legislature. Therefore, staff proposes language which is derived from the definition of an establishment from the NAICS code and the definition in Regulation 1525.2(c)(6)(B).

In defining an establishment, staff proposed that employment in the economic activity must be "significant," which staff defined as "whenever more than 25 percent of the taxpayer's total number of employees at a single physical location, or more than 25 percent of the taxpayer's total dollar value of payroll at a single physical location, is attributable to the economic activity being tested for separate establishment status." Staff contended this test assured that a "qualified person" has a significant portion of its resources devoted to postproduction activities which staff believed is consistent with the legislative intent.

Industry representatives contended that the intent of the statute is to provide a partial exemption based upon whether the tangible personal property purchased or leased is primarily used in teleproduction or other postproduction activities. They further contended the postproduction industry differs from the manufacturing industry in that the number and dollar value of payroll used in postproduction activities may be minimal, yet such activities constitute a significant portion of revenue. Therefore, the 25 percent test proposed by staff is not a reasonable test.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff has agreed to incorporate industry's definition of an "establishment" in the proposed regulation. Staff has acknowledged that the nature of the manufacturing and the postproduction industries are not comparable with respect to the percentage of employees or revenue for a particular location, as there are often multiple activities performed in a postproduction facility. In addition, staff recognizes that such a test would be more easily circumvented by larger companies who may spin off a subsidiary, leaving smaller businesses at a competitive disadvantage.

E. <u>"Animation" Regulation - 1532(c)(4)</u>

Staff proposed that the term "teleproduction or other postproduction services" specifically exclude Computer Generated Animation (CGA) involving the production of a motion picture exclusively using computer animation. In using CGA for this type of motion picture, production and postproduction work is not clearly delineated.

Industry contends that both the statute and NAICS Code 512191 include animation in the description of a postproduction activity. They further contend that animation is not characterized by the method by which it is performed or the extent to which it is used in a production. Industry is of the opinion that the statute intended for a person who is primarily engaged in animation activities to be eligible for the partial exemption.

Staff was of the opinion that companies using CGA exclusively to produce motion pictures are not entitled to the exemption under section 6378. CGA is not included in the definition of "teleproduction and other postproduction services" pursuant to NAICS Code 512191. Staff believed the term "animation" as used in the statute and NAICS Code 512191 is intended to apply only to animation which is performed postproduction and not to CGA, which staff believed to be a production activity. Therefore, even if such entities perform some postproduction activities, staff did not consider such entities to be "primarily" engaged in performing postproduction activities.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, industry provided additional information that documented animation processes as qualifying postproduction activities. Thus, staff and industry are now in agreement.

F. <u>"Synchronous Sound Recording" Regulation 1532(c)(4)(B)</u>

Prior to the meeting of interested parties on May 26, 1999, staff proposed language to reflect that postproduction audio services were not included as qualified services as such activities were not included in NAICS Code 512191. The recording of sound is specifically included in NAICS Code 512240, *Sound Recording Studios*. However, the definition of "teleproduction or other postproduction services" in section 6378(c)(3), which applies to the use of the property, includes "audio production" and "special effects (visual and sound)."

Staff and industry representatives have agreed to language that does not include the recording of music within the exemption except for music recorded with synchronous visual images, since this activity does qualify as postproduction within the meaning of the statute.

G. “Duplication Equipment” Regulation 1532(c)(5)

Industry is of the opinion that duplication equipment may be purchased under the partial exemption under section 6378 by an otherwise qualified person provided the duplication equipment is primarily used to produce copies for any teleproduction or other postproduction activities.

Staff agrees that duplication equipment purchased by an otherwise qualified person qualifies for the partial exemption provided that the duplication equipment is primarily used to produce copies for editing purposes. However, staff believes that duplication equipment purchased primarily to produce release prints will not qualify for the partial exemption, as such activities are not included under NAICS Code 512191.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff and industry have agreed upon language that allows the partial exemption for duplication equipment that is primarily used to produce copies for postproduction purposes, but excludes duplication equipment that is used to produce release copies.

H. “Film Development” – Regulation 1532(c)(5)

Industry is of the opinion that film development is a postproduction service. Since the NAICS codes overlap, they believe the equipment could qualify for the partial exemption under section 6378 if used primarily in teleproduction or other postproduction activities.

Staff was of the opinion that equipment purchased for such use does not qualify for the partial exemption under section 6378. Film development is not included under NAICS Code 512191 referenced in the statute. Instead, film processing and development activities are included under NAICS Code 512199, which is a production function.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, industry provided additional information to show that the film development is the first step in the postproduction process. Thus, staff and industry are now in agreement.

I. <u>“Generic Equipment” – Regulation 1532(c)(5)</u>

Industry contends generic or mixed-use equipment should be eligible for the section 6378 exemption.

Staff was of the opinion that “generic equipment,” that is, equipment that can serve multiple purposes and is not specific to postproduction activities (such as computers), may qualify for the partial exemption under section 6378. Such property must be purchased by a qualified person to be used primarily in teleproduction or other postproduction services. The burden of proof will be upon the purchaser to prove that the property was primarily used in teleproduction or other postproduction services for the one-year period following the date of purchase.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff and industry have agreed that the purchase of “generic equipment” is sufficiently addressed in the proposed regulation with the requirement that the property be primarily used in a qualifying manner.

J. <u>“Tangible Personal Property” - Regulation 1532(c)(5)(B)</u>

Staff had included in its proposed language the provisions of 1525.2(c)(9)(B) and 1525.2(c)(10)(B) from the *Manufacturing Equipment* regulation. These provisions, which were based upon sections 6377(b)(10)(A) (consumables) and 6377(b)(11)(B) (replacement and repair parts), respectively, provide that property will be treated as having a useful life of less than one year if such property is treated as having a useful life of less than one year for state income or franchise tax purposes. The $250 limit was added to Regulation 1525.2(c)(9)(B) at the request of some retailers who did not want their cashiers trying to determine whether they should honor an exemption certificate presented to them at the check out stand. Staff also believes that the Board concluded that the manufacturing equipment exemption was not meant to apply to small, relatively inexpensive items.

The language of section 6378(c)(4)(B) regarding repair and replacement parts is essentially identical to section 6377(b)(11)(B). Staff therefore believed that the one-year useful life provisions in Regulation 1525.2(c)(10)(B) should be incorporated into Regulation 1532. Even though section 6378 does not have a specific provision excluding consumables from the definition of tangible personal property, staff believed that it was not the legislative intent to apply the teleproduction or other postproduction services exemption to pencils, paper clips, videotapes and other consumables. To extend the partial exemption to such items would provide a minimal benefit to the purchaser while placing an administrative burden upon the retailer. Therefore, staff also proposed incorporating the provisions in Regulation 1525.2(c)(9)(B) regarding consumables into Regulation 1532.

Industry disagreed with staff's proposed language that required property to be treated as having a useful life of one or more years for state income or franchise purposes. Industry believes that the section 6378(c)(4)(B) requirement for the useful life to be one or more years is applicable to repair and replacement parts only. Industry states that some property with a useful life of over one year may be expensed under a special provision in section 179 of the Internal Revenue Code and under certain sections in the state franchise and income tax laws and language should be added to the regulation to address this property. Industry does not believe that the regulation should contain a so-called de minimus amount of $250. Additionally, industry believes that computer software should include any upgrades and enhancements.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff has conceded to industry's objection since there is no statutory basis for the restrictions proposed by staff.

K. "**<u>Construction Contracts & Improvements to Realty" – Regulation 1532(c)(6)</u>**

Industry contends that, property such as cabling, fiber optics and high speed modem lines, secondary heating and air conditioning units, lighting, special wall covers, structural equipment, sub floors that are special purpose and accessory to the building, lighting and sound rooms, are part of machinery and equipment and are generally treated as such for accounting and tax purposes. Since such items retain their character as tangible personal property, industry believes they should be eligible for the exemption under section 6378.

Section 6378 specifically applies to tangible personal property. There is no provision in this statute for construction contracts or for property which becomes an improvement to real estate. Staff was therefore of the opinion that property that is purchased and subsequently incorporated into real property was not intended to be included in the partial exemption. Staff's interpretation was consistent with the Board's interpretation of the manufacturing equipment exemption in which the Board specifically provided in Regulation 1525.2(c)(9)(A) that "tangible personal property" does not include real property, including tangible personal property to be incorporated into an improvement to real property. Because of the similarities of the two exemptions, staff had proposed incorporating most of the language from Regulation 1525.2(c)(9)(A) in its proposed Regulation 1532(c)(6)(C).

We note that Regulation 1525.2(c)(9)(A) has an exception from the real property rule for special purpose buildings, conveyance systems, and assembly lines. These exceptions are based upon specific provisions in section 6377(b)(11)(A) and (D). Section 6378 does not include a comparable exception for special purpose buildings, conveyance systems, and assembly lines.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff has agreed to language that allows the partial exemption to apply to materials when purchased as tangible personal property, and not pursuant to a construction contract unless the construction contractor is the retailer of materials under Regulation 1521(b)(2)(A)(2), and fixtures that are subsequently incorporated into realty. Staff agrees with industry that while the statute specifically excludes real property, there is no statutory support to extend the exclusion to tangible personal property that may later be incorporated into realty.

L. "Ergonomic Chairs" - Regulation 1532(c)(6)

Industry contended that the exemption should be extended to purchases of ergonomic chairs used by editors and directors for use in postproduction services.

Staff contends that the exemption does not extend to furniture, which is specifically excluded pursuant to section 6378(c)(5).

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, industry has agreed with staff's contention that the statute specifically excludes furniture.

M. "Exemption Certificates" - Regulation 1532(e)(2) and (e)(3)

Staff had originally proposed language that would require a retailer claiming the exemption to attach copies of the exemption certificates for sales or leases of tangible personal property made to a purchaser exceeding an aggregate total of $25,000 during a single calendar quarter. In addition, staff proposed that the Board may require a retailer claiming the exemption to provide copies of all exemption certificates received from qualified persons and/or to commence doing so with returns filed.

In response to industry's request, staff has eliminated the requirement that a retailer provide copies of all certificates for sales to qualified persons in excess of $25,000 in a single calendar quarter. However, staff has retained language providing that a retailer claiming the exemption must provide copies of all certificates received upon request of the Board. Staff has also added a provision that the Board may, when necessary for the efficient administration of the sales and use tax laws, notify a seller to commence filing such certificates with its returns.

As requested by industry representatives, staff has also incorporated a provision for blanket certificates to be accepted by retailers in lieu of a separate certificate for each transaction as required in Regulation 1525.2. Staff has also proposed a sample blanket exemption certificate (Regulation 1532 Exhibit B) that would be acceptable to the Board.

Staff's proposal was that a section 6378 exemption certificate must be taken by the seller for the sale to qualify. Industry also proposed that "other documents" as defined be accepted. Due to the specific type of exemption provided by section 6378, staff believed the specific 6378 exemption certificate should be used.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff and industry have agreed upon appropriate language. Staff has agreed to remove the requirement that retailers file copies of their section 6378 exemption certificates with their returns, while retaining language that requires retailers to provide copies of all exemption certificates received upon board request. Staff has also provided a list of essential elements of a section 6378 exemption certificate and incorporated a provision for a blanket certificate as requested by industry. Language has also been agreed upon to address industry's concerns with respect to the requirement that a retailer accept a certificate in a timely manner.

N. "Conversion of Property" - Regulation 1532(g)

Section 6377(e)(1) of the manufacturing equipment exemption provides that the exemption shall not apply to any sale or use of property that is removed from California or converted from an exempt use within one year of purchase. Section 6377(f) provides that if a purchaser certifies in writing to a seller that the property will be used in a particular manner, the purchaser will be liable for tax if the property is not used in a manner qualifying for the exemption or is converted to another use or removed from the state within one year of purchase.

The Board incorporated section 6377(e)(1) and (f) into Regulation 1525.2(g) and (h) and concluded that a conversion to a non-qualifying use included a sale or other transfer of the property unless the sale or other transfer was to a qualified person. Staff had proposed regulatory language similar to Regulation 1525.2(g) and (h) because section 6378(e)(3) is identical in substance to section 6377(e)(1) and section 6378(f) is identical to section 6377(f). Certain modifications were made to staff's proposed regulatory language in 1532(g) and (h) because the manufacturing equipment exemption regulation requires pre-qualification. Staff does not propose to pre-qualify persons claiming the teleproduction or other postproduction equipment exemption and therefore added the requirement that the purchaser provide the qualified person an exemption certificate in order for the qualified person to retain the exemption.

Industry contends there is no statutory support for including such transfers as a disqualifying use.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff and industry have agreed upon language to state that property that is not primarily used in this state in a qualifying manner for more than one half of the one year period following the purchase of the property is a conversion of the property. However, a sale or lease to a qualified person is not a conversion of the property. Industry representatives acknowledge that leasing is itself a non-qualifying use of the property.

O. "<u>Leases" - Regulation 1532(i)</u>

Staff's proposed language incorporated most of the leasing provisions from the manufacturing equipment exemption contained in Regulations 1525.2 and 1525.3. Section 6378 lacks specific reference to leasing activity so staff relied on prior Board direction for a similar exemption. This issue was considered by the Board for the manufacturing equipment exemption. The Board concluded that leasing is not a qualified use of the property and incorporated this conclusion in Regulation 1525.3(d). Neither of these statutes were intended to provide exemptions for leasing companies but rather for companies specializing in certain manufacturing activities or in teleproduction or other postproduction services. Therefore, it is appropriate to include the provisions of Regulation 1525.3(d) in Regulation 1532.

Industry disagreed with staff's original proposal to include in Regulation 1532 the provisions of Regulation 1525.3(d), which provided that the partial exemption is not available to lessors who lease to qualified persons or to vendors of such lessors when the lessor elects to pay sales tax reimbursement at the time of acquisition of the property or pays use tax measured by the purchase price of the property. Industry believed that because section 6377 has a leasing provision and section 6378 does not, the regulations should be different. However, the specific leasing provision in section 6377, which is in subsection (h), does not address the issue of tax-paid leases. Rather, section 6377(h) provides that the manufacturing equipment exemption may apply to leases that are continuing sales and purchases.

This was an issue that was in disagreement prior to the meeting of interested parties on May 26, 1999. Since that meeting, staff and industry have agreed upon language that defines a "qualified lessee." In addition, staff and industry agree that while the lease of property is not a qualifying use of the property, a lease of property by a qualified person to a qualified lessee is not a conversion of the property. Staff has also provided language to clarify that a purchaser who acquires property under the partial exemption has made a timely election to pay tax on their cost of the property, even if the property is later converted to a non-qualifying use.

V. Staff Recommendation

Adopt proposed regulatory language as agreed upon by staff and industry.

VI. Alternative 1

Not applicable.

Regulation 1532 – Teleproduction or Other Postproduction Service Equipment

Analysis of Proposed Staff and the Industry Language

Action Item	Staff's and Industry's Proposed Regulatory Language	Summary Comments
	(a) Partial Exemption for Property Purchased for Use in Teleproduction or Other Postproduction Services. Commencing on January 1, 1999, section 6378 of the Revenue and Taxation Code provides a partial exemption from sales and use tax for certain properties described in this regulation. The partial exemption applies to the taxes imposed by sections 6051, 6051.3, 6201, and 6201.3 of the Revenue and Taxation Code (5%), but does not apply to the taxes imposed pursuant to sections 6051.2 and 6201.2 of the Revenue and Taxation Code, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or section 35 of article XIII of the California Constitution. Subject to the limitations set forth above, this partial exemption applies to sales or use taxes imposed on the gross receipts from the sale of, and the storage, use, or other consumption in this state of, any of the following items: (1) Tangible personal property as defined in subsection (c)(5) purchased for use by a qualified person to be used primarily in teleproduction or other postproduction services. (2) Tangible personal property as defined in subsection (c)(5) purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any property described in subsection (a)(1). (b) Property Used Primarily in Administration, General Management, or Marketing. Notwithstanding any other provision of this regulation, this partial exemption shall not apply to any tangible personal property that is used primarily in administration, general management, or marketing. For purposes of this subsection, tangible personal property is used primarily in administration, general management, or marketing when it is used 50 percent or more of the time in one or more of those activities for the one year period following the date of purchase of the property.	

Regulation 1532 – Teleproduction or Other Postproduction Service Equipment

Analysis of Proposed Staff and the Industry Language

Action Item	Staff's and Industry's Proposed Regulatory Language	Summary Comments
	(c) Definitions. For purposes of this regulation:	
Consent Item #1: "Primarily"	(1) "Primarily" means tangible personal property as defined in subsection (c)(5) of this regulation used 50 percent or more of the time in an activity described in subsection (a) for the one-year period following the date of purchase of the property. Tangible personal property shall not be considered used in such activities for any period of time that the property is located outside the state, regardless of how the property is used while outside the state	Industry proposed language that did not include the term "tangible personal property" in the definition of "primarily." Language has since been agreed upon by both staff and industry.
Consent Item #2: "Qualified Person"	(2) "Qualified person" means any person whose line of business is primarily engaged in teleproduction or other postproduction activities, including postproduction audio services for film, television, and video productions, described in Code 512191 of the North American Industry Classification System (NAICS) Manual published by the United States Office of Management and Budget, 1997 edition, and as further defined in (c)(4) of this regulation. The term "qualified person" does not include persons whose line of business is primarily engaged in portrait studios providing still, video, or digital portrait photography services (NAICS Code 541921), or commercial photography services (NAICS Code 541922). For the purposes of this subsection:	Staff has agreed to include postproduction audio services since they are specifically included in the statute.
Consent Item #3: "Primarily Engaged"	(A) "Primarily engaged" means 50 percent or more of gross revenues, including intra-company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in "teleproduction or other postproduction services" for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used. In the case of a nonprofit teleproduction or other postproduction establishment, "primarily engaged" means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.	Industry objected to language proposed by staff with respect to the requirement that 50% or more of gross revenues be derived from postproduction activities for the one year period following the purchase of property. Staff and industry have since agreed upon language to apply the "gross revenue test" to the purchaser's financial year that precedes the purchase of the property.

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Analysis of Proposed Staff and the Industry Language

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	(B) For purposes of classifying a line of business, the economic unit shall be the "establishment" and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues.	
Consent Item #4: "Establishment"	(C) "Establishment" is defined as the smallest operating unit for which records provide information on the revenues and cost of operations incurred to perform the teleproduction or postproduction services. (1) The services may be provided to other divisions within the same entity or to related parties with or without direct compensation. (2) Establishments may include, but are not limited to, departments, divisions, subdivisions and product lines. (3) "Sale" includes the producing, fabricating or processing of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating or processing. When performed outside this state or when the customer issues a resale certificate, a "purchase" includes the producing, fabricating or processing of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating or processing. If such producing, fabricating or processing is performed on property described in subsection (a)(1) or (a)(2) of this regulation for a qualified person and the other requirements for the partial exemption in this regulation are met, the partial exemption applies to the gross receipts or sales price for such producing, fabricating, or processing.	While staff had originally proposed the concept of a revenue test to define an "establishment", staff has removed this provision from the proposed regulatory language.
Consent Item #5: "Teleproduction or Other Postproduction Services"	(4) "Teleproduction or other postproduction services" means services for film, video or digital multimedia formats (audio or visual) that include editing, film and video transfers, transcoding, dubbing, subtitling, credits, close captioning, audio production, special effects (visual or sound), graphics, or animation. For the purposes of this regulation, "teleproduction or other postproduction services" includes post production services and does not	Staff had proposed language to specifically exclude animation used to produce a motion picture from the definition of "teleproduction or other postproduction services" as it is

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	include production services or activities. "Teleproduction or other postproduction services" include the duplicating of film for postproduction purposes. However, the duplication of film to make release prints does not qualify as a "teleproduction or other postproduction service."	not included in NAICS section 512191. However, industry has since provided information that documented animation processes as qualifying post production services. Thus, staff and industry are now in agreement.
Consent Item #6: "Teleproduction or Other Postproduction Services"	The term "teleproduction or other postproduction services" also includes, but is not limited to:	Staff had also proposed language to specifically exclude persons who produce video games from the definition of a qualified person. While both staff and industry agree, staff deleted this language because the definition of a "video game" could not be agreed upon. Industry expressed concern that staff may interpret video games to include interactive motion pictures.
Consent Item #7: "Teleproduction or Other Postproduction Services "	(A) Services performed to transform, manipulate, assemble, and duplicate visual moving images and synchronous sound previously captured on film, video, or digital formats (audio or visual) or as data during principal photography.	Staff incorporated language proposed by industry to include services for "digital multimedia formats" as industry no longer uses only film and video.
Consent Item #8: "Teleproduction or	(B) Services to create digital images, models or miniatures or sounds that may be, but are not required to be combined with live action images. Teleproduction or other postproduction services does not include the	Staff had not included the creation of models and miniatures

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Exhibit 1

Regulation 1532 – Teleproduction or Other Postproduction Service Equipment
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Other Postproduction Services"	recording of music except music recorded with synchronous visual images.	in the definition of a postproduction service as the filming was thought to be a production function. Staff has since agreed to industry's language based upon their compelling arguments that such activities constitute postproduction services.
Consent Item #9: "Teleproduction or Other…"		Staff incorporated language provided by industry to incorporate synchronous sound recordings in the definition of qualifying services.
Consent Item #10: "Teleproduction or Other Postproduction Services"	(C) Film processing; film to tape transfers; tape to tape transfers; DVD or digital audiovisual multimedia format authoring and encoding; color correction; digitizing; on-line and off-line editing; negative cutting; assembling; animation, creating 2d images, creating 3d images (CGI), visual effects; compositing; digital video image manipulation; dirt fixes; motion control visual effects capture; scanning and recording to or from film, video or data; transform; standards or format conversion; transcoding; duplication (except as provided); titles; subtitling; credits; closed captioning; creating graphics; audio scoring; automated dialogue replacement; foley; audio mixing; audio editing; audio laybacks; audio laydowns; audio special effects; management of visual or audio assets and related files stored as data; film, video or audio (dialogue, music and effects) restoration and preservation; archiving, format transfer utilizing compression standards; film cleaning; quality control processes performed in conjunction with any other postproduction process; and creation of data files related to a service defined above. Definitions of the terms used in this subsection are provided in Appendix C.	Staff has incorporated language provided by industry that lists specific postproduction services. A list of "technical definitions" has been included as Appendix C.

Regulation 1532 – Teleproduction or Other Postproduction Service Equipment

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Consent Item #11: "Teleproduction or Other Postproduction Services"	(D) The providing of postproduction facilities, such as personnel and scoring stages or equipment where the provider is deemed to be providing a qualified teleproduction or other postproduction service, is not a lease of tangible personal property. (E) The providing of special configured equipment to be used in (A) through (D) above with 24 hour a day, 7-day a week available on site technical support where the provider is deemed to be providing a qualified teleproduction or other postproduction service, is not a lease of tangible personal property. (5) "Tangible personal property" includes, but is not limited to, all of the following:	Staff and industry agreed upon language in (D) and (E).
Consent Item #12: "Tangible Personal Property"	(A) Machinery and equipment, including component parts. Machinery and equipment includes, but is not limited to, duplication equipment used for postproduction purposes and any property used to provide teleproduction or other postproduction services that is mounted or installed in a vehicle.	Industry had requested that vehicles be included in the definition of tangible personal property for the purpose of this exemption. Industry has since agreed that the statute specifically excludes vehicles.
Consent Item #13: "Tangible Personal Property"	(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, audio and visual monitoring equipment, scopes, computers, data processing equipment, electronic data storage equipment, including both internal and external devices, consoles which are custom built, which have open compartments in which tangible personal property described in subsections (a)(1) and (a)(2) is placed and which are not suitable for use for other purposes, equipment racks and computer software, including both operating programs and application programs. This also includes all repair and replacement parts with a useful life of one or more years whether purchased separately or in conjunction with a complete machine and regardless of whether the	Staff had proposed language to require a minimum of $250 per unit and require that *all* property be treated as a depreciable asset for income tax purposes. Staff has since conceded to industry's objection that there is no statutory basis for such requirements.
Consent Item #14:		Staff had excluded custom

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"Tangible Personal Property"	machine or component parts are assembled by the taxpayer or another party. Repair and replacement parts that are treated as a depreciable asset for financial purposes will be treated as having a useful life of more than one year for the purposes of this regulation, even when such items are expensed for income tax purposes under the special provisions of Internal Revenue Code Section 179.	consoles and equipment racks from the definition of tangible personal property, as the statute excludes furniture. Staff and industry have since agreed on language to restrict the exemption to custom built consoles that are not suitable for any other use.
Consent Item #15: "Tangible Personal Property"	(C) Materials (as defined in Regulation 1521), only when purchased by a qualified person as tangible personal property and not pursuant to a construction contract, unless the construction contractor is the retailer of materials under regulation 1521(b)(2)(A)(2); fixtures; or other tangible personal property used to operate, control, regulate, or maintain the property described in subsections (a)(1) and (a)(2) which may subsequently be incorporated into real property, including but not limited to items such as air conditioning units dedicated to cooling equipment, electrical UPS (uninterrupted power source) units, sub-flooring, specialized lighting, sound insulation, hydraulics, cabling, routers, patch bays, hubs, robotic storage and retrieval equipment, switchers, satellite and/or other telecommunications equipment used to facilitate the distribution or movement of elements (in either video or data form) between all the various parties collaborating in the completion of a film or video project as part of the postproduction process. (6) "Tangible personal property" does not include any of the following:	Staff was of the opinion that tangible personal property purchased that is subsequently incorporated into realty does not qualify for the partial exemption. Staff now agrees with industry's position that the statute excludes real property only and that the exclusion does not extend to tangible personal property that is subsequently incorporated into realty.
Consent Item #16: "Tangible Personal Property"	(A) Furniture, inventory, meals, vehicles (including those in or on which qualifying property is mounted or installed,) or equipment used to store products. The term "furniture" includes, but is not limited to, tables, chairs, desks or consoles other than those described in subsection (c)(5)(B).	Industry proposed that the partial exemption extend to ergonomic chairs. Industry has since agreed with staff's position that ergonomic chairs constitute furniture which is specifically

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		excluded by statute.
	(B) Real property.	
	(d) Taxes as to Which the Partial Exemption Does Not Apply. This partial exemption does not apply to any tax levied by a county, city, or district pursuant to, or in accordance with, either the Bradley-Burns Uniform Local Sales and Use Tax Law (Rev. & Tax. Code §§ 7200 et seq.) or the Transactions and Use Tax Law (Rev. & Tax Code §§ 7251 et seq.).	
	This partial exemption also does not apply to any tax levied pursuant to section 6051.2 and 6201.2 of the Revenue and Taxation Code, or pursuant to section 35 of article XIII of the California Constitution.	
	(e) Section 6378 Exemption Certificate.	
Consent Item #17: "Exemption Certificates"	(1) Qualified persons who purchase or lease tangible personal property from an in-state seller or an out-of-state seller obligated to collect use tax, must provide the seller with a section 6378 exemption certificate in order for the seller to claim the partial exemption. If the seller takes a complete section 6378 exemption certificate timely and in good faith, the certificate relieves the seller from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser.	Staff has recommended language that parallels Regulation 1668 with respect to the definition of a timely certificate. Industry proposed that a certificate taken within 30 days of *final payment* be deemed timely. Industry has since agreed to concerns raised by staff that the final payment may be years later in cases of seller financing or leases, and withdrew this proposal.
	A section 6378 exemption certificate which is not taken timely will not relieve the seller of the liability for tax excluded by the partial exemption unless the seller presents satisfactory evidence to the Board that the specific property was sold to a qualified person and primarily used in a qualifying manner.	

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	The exemption certificate should be in substantially the same form as it appears in Appendix A of this regulation.	
Consent Item #18: "Exemption Certificates"	(2) Blanket Certificates. In lieu of requiring an exemption certificate for each transaction, a qualified person may issue a blanket exemption certificate. The blanket exemption certificate should appear in substantially the same form as it appears in Appendix B of this regulation. Qualified persons claiming the partial exemption through a blanket exemption certificate must make a clear reference to the blanket exemption certificate in documents such as their written purchase orders, sales agreements, leases, or contracts. Qualified persons claiming the partial exemption must also include in the document referencing the blanket exemption certificate a description of the property.	Staff has agreed to incorporate the concept of a blanket certificate in lieu of individual exemption certificates.
	(3) Form of Certificate. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as an exemption certificate with respect to the sale of the property described in the document if it contains all of the following essential elements: (A) The signature of the purchaser or an agent or employee of the purchaser. (B) The name and address of the purchaser. (C) The seller's permit number held by the purchaser, or a notation to the effect that the purchaser is not required to hold a permit. (D) A statement that the property acquired is to be used primarily in teleproduction or other postproduction services or to be used primarily to maintain, repair, measure, or test any such property (E) A statement that the purchaser is a qualified person primarily engaged in teleproduction or other postproduction services as described in Regulation 1532. (F) Description of property purchased, including sales price or rentals payable. (G) Date executed.	Industry agreed with language proposed by staff that would provide the required essential elements of a certificate. Industry and staff have since agreed to language that eliminated several non-essential components from the original language.

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	(4) Retention and Availability of Certificates. A seller must retain each exemption certificate, including a blanket exemption certificate, received from a qualified person for a period of not less than four years from the date on which the seller claims a partial exemption based on the exemption certificate. If a qualified person issues a blanket exemption certificate, the seller must also retain all documents, such as purchase orders, sales agreements, lease agreements, or contracts referencing the blanket exemption certificate and all invoices containing the sales price of the property that the qualified person claims is partially exempt by reference to the blanket exemption certificate. Such documents shall be retained for a period of not less than four years from the date on which the seller claims a partial exemption based on the reference to the blanket exemption certificate. While the Board will not normally require the filing of the Section 6378 exemption certificate with a sales and use tax return, when necessary for the efficient administration of the sales and use tax laws, the Board may, on 30 days' written notice, require a seller to commence filing with its sales and use tax returns copies of all certificates. The Board may also require that, within 45 days of the Board's request, sellers furnish to the Board any and all exemption certificates, or copies thereof, accepted for the purpose of supporting the partial exemption.	
Consent Item #19: "Exemption Certificates"	(5) If a purchaser who issues a section 6378 exemption certificate pursuant to subsection (e)(1), (2), or (3) subsequently does not meet the requirements of a qualified person as set forth in subsection (c)(2) or does not use the property in a manner or for the purpose which entitles the purchaser to the partial exemption, or if a purchaser issues a section 6378 exemption certificate pursuant to subsection (e)(1), (2), or (3) for property that does not qualify for the partial exemption, the purchaser shall be liable for	Language proposed by staff stated that if a purchaser subsequently does not meet the definition of a qualified person or makes a conversion of the property, tax will be due based as of the date of purchase of the property. Staff

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	payment of the sales tax excluded by the partial exemption, with applicable interest, to the same extent as if the purchaser were a seller making a retail sale of the property at the time of conversion. The sales price of the property to the purchaser shall be deemed to be the gross receipts from that retail sale. (f) Use Tax. With respect to tangible personal property the use of which is subject to use tax, any purchaser claiming the partial exemption pursuant to Section 6378 of the Revenue and Taxation Code must file a sales and use tax return or consumer use tax return for the period in which the property is first stored, used, or consumed in California unless the seller holds a valid California seller's permit or a Certificate of Registration – Use Tax and collects the use tax. The purchaser will not be relieved of his or her liability to pay any applicable use tax that is excluded from the partial exemption as provided in subsection (d) of this regulation until such tax is remitted either to a vendor who issues a receipt which meets the requirements of Regulation 1686 or directly to the Board. (g) Conversion of Property to a Use Not Qualifying for the Partial Exemption. Property that, within one year from the date of purchase, is removed from California, converted from an exempt use under this regulation to some other use not qualifying for the partial exemption, or used in a manner not qualifying for the partial exemption under this regulation, such as a lease to a non-qualified person, is used in a non-qualifying manner. If, as a result of the total non-qualifying use, the property is not primarily used, as defined in subsection (c)(1), in a qualifying activity, the partial exemption shall not apply. In determining the non-qualifying use, two or more non-qualifying uses that occur at the same time shall be counted as one. For example, a lease to a non qualified person of property that is removed from California shall be considered as one non-qualifying use for the period it was removed from California and leased to a non-qualified person.	has since agreed with industry's interpretation of the statute that tax is due as of the date of conversion.
Consent Item #20: "Conversion of	The property shall not, however, be regarded as being converted to a use not qualifying for the partial exemption if the qualified person sells or leases	Staff had proposed language to reflect that a lease or sale is a

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Property"	the property to a qualified person for qualified use in California. For purposes of this subsection, tangible personal property shall not be regarded as being converted to a non-qualifying use if such property is used for teleproduction or other postproduction services in this state for more than one half of the one year period from the date of purchase of the property.	conversion of the property. Staff has since yielded to objections by industry and has amended the language to reflect that a sale or lease to a qualified person is not a conversion of the property.
Consent Item #21: "Conversion of Property"	(h) Purchaser's Liability for the Payment of Sales Tax. If a purchaser submits a Section 6378 exemption certificate to the seller, and then within one year of the date of purchase of the property converts that property as described in subsection (g) from an exempt use pursuant to this regulation to some other use not qualifying for the partial exemption, the purchaser shall be liable for payment of sales tax excluded by the partial exemption, with applicable interest, to the same extent as if the purchaser were a seller making a retail sale of the property at the time the property was so removed, converted, or used; and the sales price of the property to the purchaser shall be deemed to be the gross receipts from that retail sale. In the case of a non-qualifying lease, the payment of sales tax by a purchaser when included on the return for the period covering the date of conversion shall be deemed to be a timely election to pay tax based on the purchase price. (i) Leases. (1) Leases—In General. Leases of tangible personal property which are classified as "continuing sales" and "continuing purchases" of tangible personal property, in accordance with Regulation 1660, "Leases of Tangible Personal Property - In General," may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. This partial exemption may apply to rental receipts paid by a qualified person with respect to a lease of tangible personal property to the qualified person, which tangible personal property is used as set forth in subsections (a)(1) and (a)(2) of this regulation, notwithstanding the fact that the lease was	Staff has incorporated language proposed by industry to clarify that a purchaser of property subject to the partial exemption has made the timely election to pay tax on cost, even if the property is converted to a non qualifying use within the one year period following the purchase and the purchaser is later held liable for the full tax based on the purchase price.

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	entered into prior to the operative date of this regulation. For purposes of this subsection, a non-qualified person may purchase property for resale and subsequently lease the property to a qualified person subject to the partial exemption. A lessee is a qualified person if the lessee is "primarily engaged" in teleproduction or other postproduction activities and meets the requirements of a qualified person set forth in subsection (c)(2).	
Consent Item #22: "Leases"	(2) Leases of Tax Paid Property. The partial exemption does not apply to the sale of property to, or the storage, use, or other consumption of property by, a person who is not a qualified person even if that person subsequently leases the property to a qualified person.	Pursuant to the meeting of interested parties on May 26, 1999, staff proposed language to clarify the definition of a qualified lessee. Industry and staff have agreed to this language.
	(3) Leases of property by a qualified person. If a qualified person has acquired property subject to the partial exemption provided by this regulation, the subsequent lease of that property will not be subject to tax measured by rental receipts. A lease of property to a qualified person for use in a qualifying manner constitutes a qualifying use of the property by the lessor. If, however, the property is used in a manner not qualifying for the exemption, such as being leased to a nonqualified person in the aggregate for more than one half of the one year period following the date of purchase by the qualified person, such property is not considered to be primarily used in "teleproduction or other postproduction services." Therefore, the lessor will be liable for tax in accordance with subsection (e)(5). For example, if a qualified person purchases property under the partial exemption, and then leases the property to a nonqualified person, the lease receipts will not be subject to tax as the purchaser has elected to pay tax on their cost. However, if the qualified person who purchases the property leases the property to a nonqualified person for more than one half of the	Staff had proposed language to reflect that leasing is a nonqualified use of property. Staff and industry have since agreed to language that allows a qualified person to claim the exemption if they use the property in a qualified manner for more than one half of the one year period following the purchase. In addition, a lease to a qualified person is not considered a conversion of the property or a non-qualified use.

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	one year period following the date of purchase, the lessor is not using the property in a qualifying manner and is responsible for the tax excluded by the partial exemption based upon the purchase price of the property. (4) Leases - Recharacterization. With respect to transactions which the parties denominate as a "lease," but which are recharacterized for sales and use tax purposes either as sales at their inception, pursuant to Regulation 1641, "Credit Sales and Repossessions," subsection (b), or as sales under a security agreement, Regulation 1660, "Leases of Tangible Personal Property - In General," subsection (a)(2), the transactions may qualify for the partial exemption, in accordance with this regulation. (5) Leases - Acquisition Sale and Leaseback. A qualified person will be regarded as having paid sales tax reimbursement or use tax with respect to that person's purchase of property, within the meaning of those words as they are used in section 6010.65 of the Revenue and Taxation Code, if the qualified person has paid all applicable taxes with respect to the acquisition of the property, notwithstanding the fact that the sale and purchase of the property may have been subject to the partial exemption from tax provided by this regulation. (j) Records. Adequate and complete records must be maintained by the purchaser to support that the property purchased was used primarily in the performance of teleproduction or other postproduction services for a period of no less than one year prior to conversion of the property to a non-qualifying use or use by a non qualifying party. (k) Operative Date. This regulation is operative as of January 1, 1999. The partial exemption under section 6378 only applies to qualifying tangible personal property that is sold or first stored, used, or consumed in California on or after the operative date.	

BOARD OF EQUALIZATION

REVENUE ESTIMATE

REGULATION 1532 — TELEPRODUCTION OR OTHER POSTPRODUCTION SERVICE EQUIPMENT ISSUE PAPER NUMBER 99–027

Proposal

This proposed new regulation would implement the partial exemption from the sales and use tax of certain teleproduction or other postproduction service equipment.

Background, Methodology, and Assumptions

Assembly Bill 2798, Chapter 323, Statutes of 1998 added Section 6378 to the Revenue and Taxation Code. That section provides an exemption from the 5% State General Fund sales and use tax on purchases by qualified persons of personal property to be used primarily in teleproduction or other postproduction services. A number of meetings of Board staff and industry representatives have been held to discuss the interpretation of portions of the new section. Although there were disagreements among the parties initially regarding the interpretation of some portions, the parties are now in agreement on all items having revenue significance.

Revenue Summary

Since this is a new regulation intended to implement recently enacted legislation and there is general agreement among parties on the wording of the new regulation, we view the regulation as having no revenue effect. Any revenue effect results from enactment of the statute itself.

Qualifying Remarks

The elements of AB 2798 pertaining to teleproduction and other postproduction services were initially contained in AB 2427 of the 1997-98 Session. Board staff estimated that AB 2427 would reduce sales and use tax revenues by $5 million to $10 million, annually. Upon further review of the legislation, staff now feels that 1) the statute affects more sectors of the industry than were reflected in the revenue estimate and 2) rapid technological changes throughout the industry probably have increased capital expenditures above the levels used for those sectors that were covered by the estimate. Consequently, the effect of the legislation is probably at least twice as large as estimated at the time it was being considered by the Legislature.

Preparation

This revenue estimate was prepared by Jeff Reynolds, Statistics Section, Agency Planning and Research Division. The estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Ms. Freda Orendt-Evans, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Reynolds at (916) 445-0840.

Current as of June 10, 1999

JCK: 12/16/98, 1/4/99, 1/11/99, 2/1/99, 3/3/99,
4/5/99, 4/30/99, 5/20/99, 6/15/99, 6/23/99

Regulation 1532. Teleproduction or Other Postproduction Service Equipment.

(a) Partial Exemption for Property Purchased for Use in Teleproduction or Other Postproduction Services. Commencing on January 1, 1999, section 6378 of the Revenue and Taxation Code provides a partial exemption from sales and use tax for certain properties described in this regulation. The partial exemption applies to the taxes imposed by sections 6051, 6051.3, 6201, and 6201.3 of the Revenue and Taxation Code (5%), but does not apply to the taxes imposed pursuant to sections 6051.2 and 6201.2 of the Revenue and Taxation Code, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or section 35 of article XIII of the California Constitution.

Subject to the limitations set forth above, this partial exemption applies to sales or use taxes imposed on the gross receipts from the sale of, and the storage, use, or other consumption in this state of, any of the following items:

(1) Tangible personal property as defined in subsection (c)(5) purchased for use by a qualified person to be used primarily in teleproduction or other postproduction services.

(2) Tangible personal property as defined in subsection (c)(5) purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any property described in subsection (a)(1).

(b) Property Used Primarily in Administration, General Management, or Marketing. Notwithstanding any other provision of this regulation, this partial exemption shall not apply to any tangible personal property that is used primarily in administration, general management, or marketing. For purposes of this subsection, tangible personal property is used primarily in administration, general management, or marketing when it is used 50 percent or more of the time in one or more of those activities for the one year period following the date of purchase of the property.

(c) Definitions. For purposes of this regulation:

(1) “Primarily” means tangible personal property as defined in subsection (c)(5) of this regulation used 50 percent or more of the time in an activity described in subsection (a) for the one-year period following the date of purchase of the property. Tangible personal property shall not be considered used in such activities for any period of time that the property is located outside the state, regardless of how the property is used while outside the state

(2) "Qualified person" means any person whose line of business is primarily engaged in teleproduction or other postproduction activities, including postproduction audio services for film, television, and video productions, described in Code 512191 of the North American Industry Classification System (NAICS) Manual published by the United States Office of Management and Budget, 1997 edition, and as further defined in (c)(4) of this regulation. The term "qualified person" does not include persons whose line of business is primarily engaged in portrait studios providing still, video, or digital portrait photography services (NAICS Code 541921), or commercial photography services (NAICS Code 541922). For the purposes of this subsection:

(A) "Primarily engaged" means 50 percent or more of gross revenues, including intra-company charges, are derived from teleproduction or other postproduction activities for the financial year of the purchaser preceding the purchase of the property. In cases where the purchaser was not primarily engaged in "teleproduction or other postproduction services" for the financial year preceding the purchase of the property, the one year period following the date of purchase of the property will be used. In the case of a nonprofit teleproduction or other postproduction establishment, "primarily engaged" means 50 percent or more of the funds allocated to the establishment are attributable to teleproduction or other postproduction services.

(B) For purposes of classifying a line of business, the economic unit shall be the "establishment" and the classification of the line or lines of business will be based on the establishment's primary activity based upon gross revenues.

(C) "Establishment" is defined as the smallest operating unit for which records provide information on the revenues and cost of operations incurred to perform the teleproduction or postproduction services.
   (1) The services may be provided to other divisions within the same entity or to related parties with or without direct compensation.
   (2) Establishments may include, but are not limited to, departments, divisions, subdivisions and product lines.

(3) "Sale" includes the producing, fabricating or processing of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating or processing. When performed outside this state or when the customer issues a resale certificate, a "purchase" includes the producing, fabricating or processing of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating or processing. If such producing,

fabricating or processing is performed on property described in subsection (a)(1) or (a)(2) of this regulation for a qualified person and the other requirements for the partial exemption in this regulation are met, the partial exemption applies to the gross receipts or sales price for such producing, fabricating, or processing.

(4) "Teleproduction or other postproduction services" means services for film, video, or digital multimedia formats (audio or visual) that include editing, film and video transfers, transcoding, dubbing, subtitling, credits, close captioning, audio production, special effects (visual or sound), graphics, or animation. For the purposes of this regulation, "teleproduction or other postproduction services" includes postproduction services and does not include production services or activities. "Teleproduction or other postproduction services" include the duplicating of film for postproduction purposes. However, the duplication of film to make release prints does not qualify as a "teleproduction or other postproduction service."

The term "teleproduction or other postproduction services" also includes, but is not limited to:

(A) Services performed to transform, manipulate, assemble, and duplicate visual moving images and synchronous sound previously captured on film, video, or digital formats (audio or visual) or as data during principal photography.
(B) Services to create digital images, models, miniatures or sounds that may be, but are not required to be combined with live action images. Teleproduction or other postproduction services does not include the recording of music except music recorded with synchronous visual images.
(C) Film processing; film to tape transfers; tape to tape transfers; DVD or digital audiovisual multimedia format authoring and encoding; color correction; digitizing; on-line and off-line editing; negative cutting; assembling; animation, creating 2d images, creating 3d images (CGI), visual effects; compositing; digital video image manipulation; dirt fixes; motion control visual effects capture; scanning and recording to or from film, video or data; transform; standards or format conversion; transcoding; duplication (except as provided); titles; subtitling; credits; closed captioning; creating graphics; audio scoring; automated dialogue replacement; foley; audio mixing; audio editing; audio laybacks; audio laydowns; audio special effects; management of visual or audio assets and related files stored as data; film, video or audio (dialogue, music and effects) restoration and preservation; archiving, format transfer utilizing compression standards; film cleaning; quality control processes performed in conjunction with any other postproduction process; and creation of data files related to a service defined above.

Definitions of the terms used in this subsection are provided in Appendix C.

(D) The providing of postproduction facilities, such as personnel and scoring stages or equipment where the provider is deemed to be providing a qualified teleproduction or other postproduction service, is not a lease of tangible personal property.

(E) The providing of special configured equipment to be used in (A) through (D) above with 24 hour a day, 7-day a week available on site technical support where the provider is deemed to be providing a qualified teleproduction or other postproduction service, is not a lease of tangible personal property.

(5) "Tangible personal property" includes, but is not limited to, all of the following:

(A) Machinery and equipment, including component parts. Machinery and equipment includes, but is not limited to, duplication equipment used for postproduction purposes and any property used to provide teleproduction or other postproduction services that is mounted or installed in a vehicle.

(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, audio and visual monitoring equipment, scopes, computers, data processing equipment, electronic data storage equipment, including both internal and external devices, consoles which are custom built, which have open compartments in which tangible personal property described in subsections (a)(1) and (a)(2) is placed and which are not suitable for use for other purposes, equipment racks and computer software, including both operating programs and application programs. This also includes all repair and replacement parts with a useful life of one or more years whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party. Repair and replacement parts that are treated as a depreciable asset for financial purposes will be treated as having a useful life of more than one year for the purposes of this regulation, even when such items are expensed for income tax purposes under the special provisions of Internal Revenue Code Section 179.

(C) Materials (as defined in Regulation 1521), only when purchased by a qualified person as tangible personal property and not pursuant to a construction contract, unless the construction contractor is the retailer of materials under Regulation 1521(b)(2)(A)(2); fixtures; or other tangible personal property used to operate, control, regulate, or maintain the property described in subsections (a)(1) and (a)(2) which may subsequently be incorporated into real property, including but not limited to items such as air conditioning units dedicated to cooling equipment, electrical UPS (uninterrupted power source) units, sub-flooring, specialized lighting, sound insulation, hydraulics, cabling, routers, patch bays, hubs, robotic storage and retrieval equipment, switchers, satellite and/or other telecommunications equipment used to facilitate the distribution or movement of elements (in either video or data form) between all the various parties collaborating in the completion of a film or video project as part of the postproduction process.

(6) "Tangible personal property" does not include any of the following:

(A) Furniture, inventory, meals, vehicles (including those in or on which qualifying property is mounted or installed,) or equipment used to store products. The term "furniture" includes, but is not limited to, tables, chairs, desks or consoles other than those described in subsection (c)(5)(B).

(B) Real property.

(d) Taxes as to Which the Partial Exemption Does Not Apply. This partial exemption does not apply to any tax levied by a county, city, or district pursuant to, or in accordance with, either the Bradley-Burns Uniform Local Sales and Use Tax Law (Rev. & Tax. Code §§ 7200 et seq.) or the Transactions and Use Tax Law (Rev. & Tax Code §§ 7251 et seq.).

This partial exemption also does not apply to any tax levied pursuant to section 6051.2 and 6201.2 of the Revenue and Taxation Code, or pursuant to section 35 of article XIII of the California Constitution.

(e) Section 6378 Exemption Certificate.

(1) Qualified persons who purchase or lease tangible personal property from an in-state seller, or an out-of-state seller obligated to collect use tax, must provide the seller with a section 6378 exemption certificate in order for the seller to claim the partial exemption. If the seller takes a complete section 6378 exemption certificate timely and in good faith, the certificate relieves the seller from the liability for the sales tax subject to exemption under this regulation or the duty of collecting the use tax subject to exemption under this regulation. A certificate will be considered timely if it is taken any time before the seller bills the purchaser for the property, any time within the seller's normal billing or payment cycle, or any time at or prior to delivery of the property to the purchaser.

A section 6378 exemption certificate which is not taken timely will not relieve the seller of the liability for tax excluded by the partial exemption unless the seller presents satisfactory evidence to the Board that the specific property was sold to a qualified person and primarily used in a qualifying manner.

The exemption certificate should be in substantially the same form as it appears in Appendix A of this regulation.

(2) Blanket Certificates. In lieu of requiring an exemption certificate for each transaction, a qualified person may issue a blanket exemption certificate. The blanket exemption certificate should appear in substantially the same form as it appears in Appendix B of this regulation. Qualified persons claiming the partial exemption through a blanket exemption certificate must make a clear reference to the blanket exemption certificate in documents such as their written purchase orders, sales agreements, leases, or contracts. Qualified persons claiming the partial exemption must also include in the document referencing the blanket exemption certificate a description of the property.

(3) Form of Certificate. Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as an exemption certificate with respect to the sale of the property described in the document if it contains all of the following essential elements:

- (A) The signature of the purchaser or an agent or employee of the purchaser.
- (B) The name and address of the purchaser
- (C) The seller's permit number held by the purchaser, or a notation to the effect that the purchaser is not required to hold a permit.
- (D) A statement that the property acquired is to be used primarily in teleproduction or other postproduction services or to be used primarily to maintain, repair, measure, or test any such property.
- (E) A statement that the purchaser is a qualified person primarily engaged in teleproduction or other postproduction services as described in Regulation 1532.
- (F) Description of property purchased, including sales price or rentals payable.
- (G) Date executed.

(4) Retention and Availability of Certificates. A seller must retain each exemption certificate, including a blanket exemption certificate, received from a qualified person for a period of not less than four years from the date on which the seller claims a partial exemption based on the exemption certificate. If a qualified person issues a blanket exemption certificate, the seller must also retain all documents, such as purchase orders, sales agreements, lease

agreements, or contracts referencing the blanket exemption certificate and all invoices containing the sales price of the property that the qualified person claims is partially exempt by reference to the blanket exemption certificate. Such documents shall be retained for a period of not less than four years from the date on which the seller claims a partial exemption based on the reference to the blanket exemption certificate.

While the Board will not normally require the filing of the Section 6378 exemption certificate with a sales and use tax return, when necessary for the efficient administration of the sales and use tax laws, the Board may, on 30 days' written notice, require a seller to commence filing with its sales and use tax returns copies of all certificates. The Board may also require that, within 45 days of the Board's request, sellers furnish to the Board any and all exemption certificates, or copies thereof, accepted for the purpose of supporting the partial exemption.

(5) If a purchaser who issues a section 6378 exemption certificate pursuant to subsection (e)(1), (2), or (3) subsequently does not meet the requirements of a qualified person as set forth in subsection (c)(2) or does not use the property in a manner or for the purpose which entitles the purchaser to the partial exemption, or if a purchaser issues a section 6378 exemption certificate pursuant to subsection (e)(1), (2), or (3) for property that does not qualify for the partial exemption, the purchaser shall be liable for payment of the sales tax excluded by the partial exemption, with applicable interest, to the same extent as if the purchaser were a seller making a retail sale of the property at the time of conversion. The sales price of the property to the purchaser shall be deemed to be the gross receipts from that retail sale.

(f) Use Tax. With respect to tangible personal property the use of which is subject to use tax, any purchaser claiming the partial exemption pursuant to Section 6378 of the Revenue and Taxation Code must file a sales and use tax return or consumer use tax return for the period in which the property is first stored, used, or consumed in California unless the seller holds a valid California seller's permit or a Certificate of Registration – Use Tax and collects the use tax. The purchaser will not be relieved of his or her liability to pay any applicable use tax that is excluded from the partial exemption as provided in subsection (d) of this regulation until such tax is remitted either to a vendor who issues a receipt which meets the requirements of Regulation 1686 or directly to the Board.

(g) Conversion of Property to a Use Not Qualifying for the Partial Exemption. Property that, within one year from the date of purchase, is removed from California, converted from an exempt use under this regulation to some other use not qualifying for the partial exemption, or used in a manner not qualifying for the partial exemption under this regulation, such as a lease to a non-qualified person, is used in a non-qualifying manner. If, as a result of the total non-qualifying use, the property is not primarily used, as defined in subsection (c)(1), in a qualifying activity, the partial exemption shall not apply. In determining the non-qualifying use, two or more non-qualifying uses that occur at the same time shall be counted as one. For example, a lease to a non-qualified person of property that is removed from California shall be considered as one non-qualifying use for the period it was removed from California and leased to a non-qualified person.

The property shall not, however, be regarded as converted to a use not qualifying for the partial exemption if the qualified person sells or leases the property to a qualified person for qualified use in California.

For purposes of this subsection, tangible personal property shall not be regarded as being converted to a non-qualifying use if such property is used for teleproduction or other postproduction services in this state for more than one half of the one year period from the date of purchase of the property.

(h) Purchaser's Liability for the Payment of Sales Tax. If a purchaser submits a Section 6378 exemption certificate to the seller, and then within one year of the date of purchase of the property converts that property as described in subsection (g) from an exempt use pursuant to this regulation to some other use not qualifying for the partial exemption, the purchaser shall be liable for payment of sales tax excluded by the partial exemption, with applicable interest, to the same extent as if the purchaser were a seller making a retail sale of the property at the time the property was so removed, converted, or used; and the sales price of the property to the purchaser shall be deemed to be the gross receipts from that retail sale. In the case of a non-qualifying lease, the payment of sales tax by a purchaser when included on the return for the period covering the date of conversion shall be deemed to be a timely election to pay tax based on the purchase price.

(i) Leases.

(1) Leases - In General. Leases of tangible personal property which are classified as "continuing sales" and "continuing purchases" of tangible personal property, in accordance with Regulation 1660, "Leases of Tangible Personal Property - In General," may qualify for the partial exemption subject to all the limitations and conditions set forth in this regulation. This partial exemption may apply to rental receipts paid by a qualified person with respect to a lease of tangible personal property to the qualified person, which tangible personal property is used as set forth in subsections (a)(1) and (a)(2) of this regulation, notwithstanding the fact that the lease was entered into prior to the operative date of this regulation. For

purposes of this subsection, a non-qualified person may purchase property for resale and subsequently lease the property to a qualified person subject to the partial exemption.

A lessee is a qualified person if the lessee is "primarily engaged" in teleproduction or other postproduction activities and meets the requirements of a qualified person set forth in subsection (c)(2).

(2) Leases of Tax-Paid Property. The partial exemption does not apply to the sale of property to, or the storage, use, or other consumption of property by, a person who is not a qualified person even if that person subsequently leases the property to a qualified person.

(3) Lease of Property By a Qualified Person. If a qualified person has acquired property subject to the partial exemption provided by this regulation, the subsequent lease of that property will not be subject to tax measured by rental receipts. A lease of property to a qualified person for use in a qualified manner constitutes a qualifying use of the property by the lessor. If, however, the property is used in a manner not qualifying for the exemption, such as being leased to a non-qualified person in the aggregate for more than one half of the one year period following the date of purchase by the qualified person, such property is not considered to be primarily used in "teleproduction or other postproduction services." Therefore, the lessor will be liable for tax in accordance with subsection (e)(5).

For example, if a qualified person purchases property under the partial exemption, and then leases the property to a non-qualified person, the lease receipts will not be subject to tax as the purchaser has elected to pay tax on their cost. However, if the qualified person who purchases the property leases the property to a non-qualified person for more than one half of the one year period following the date of purchase, the lessor is not using the property in a qualifying manner and is responsible for the tax excluded by the partial exemption based upon the purchase price of the property.

(4) Leases - Recharacterization. With respect to transactions which the parties denominate as a "lease," but which are recharacterized for sales and use tax purposes either as sales at their inception, pursuant to Regulation 1641, "Credit Sales and Repossessions," subsection (b), or as sales under a security agreement, Regulation 1660, "Leases of Tangible Personal Property - In General," subsection (a)(2), the transactions may qualify for the partial exemption, in accordance with this regulation.

JCK: 12/16/98, 1/4/99, 1/11/99, 2/1/99, 3/3/99,
4/5/99, 4/30/99, 5/20/99, 6/15/99, 6/23/99

(5) Leases - Acquisition Sale and Leaseback. A qualified person will be regarded as having paid sales tax reimbursement or use tax with respect to that person's purchase of property, within the meaning of those words as they are used in section 6010.65 of the Revenue and Taxation Code, if the qualified person has paid all applicable taxes with respect to the acquisition of the property, notwithstanding the fact that the sale and purchase of the property may have been subject to the partial exemption from tax provided by this regulation.

(j) Records. Adequate and complete records must be maintained by the purchaser to support that the property purchased was used primarily in the performance of teleproduction or other postproduction services for a period of no less than one year prior to conversion of the property to a non-qualifying use or use by a non qualifying party.

(k) Operative Date. This regulation is operative as of January 1, 1999. The partial exemption under section 6378 only applies to qualifying tangible personal property that is sold or first stored, used, or consumed in California on or after the operative date.

Note: Authority: Section 7051, Revenue and Taxation Code.
Reference: Section 6378, Revenue and Taxation Code.

JCK: 12/16/98, 1/4/99, 1/11/99, 2/1/99, 3/3/99,
4/5/99, 4/30/99, 5/20/99, 6/15/99, 6/23/99

Appendix A

Section 6378 Exemption Certificate

Please Note: This is a partial exemption from sales and use tax at the rate of 5% effective January 1, 1999. You are not relieved from your obligations for the local and district taxes on this transaction. This partial exemption also does not apply to any tax levied pursuant to section 6051.2 and 6201.2 of the Revenue and Taxation Code, or pursuant to section 35 of article XIII of the California Constitution. The exemption is specific to these transactions only and may not be construed to exempt other transactions. This exemption also applies to lease payments made on or after January 1, 1999, notwithstanding the fact that the lease agreement was entered into prior to January 1, 1999. This certificate may *not* be used to purchase certain property such as, furniture, inventory, meals, vehicles, equipment used to store products or real property.

Seller's Name

Seller's Address
(Street, City, State, Zip Code)

PURCHASE ORDER NUMBER	DATE OF PURCHASE ORDER	DESCRIPTION OF PROPERTY PURCHASED OR LEASED*	SALES PRICE/ RENTALS PAYABLE

I hereby certify that I am a qualified person primarily engaged in teleproduction or other postproduction services as described in Regulation 1532 and that the property listed above will be used primarily in teleproduction or other postproduction services or to maintain, repair, measure or test any such property. I understand that if such property is used outside the State of California or leased to a non-qualified person in the aggregate for more than one half of the one year period following the date of purchase or lease, or if such property is converted for use in a manner not qualifying for the exemption, that I am required by the Sales and Use Tax Law to report and pay the state sales/use tax measured by the sales price of the property to/by me.

PRINT NAME	TITLE	COMPANY NAME
SIGNATURE	DATE	PERMIT NUMBER (if applicable)*
ADDRESS	CITY	STATE, ZIP

Seller must retain a copy of this exemption certificate to support a deduction taken on their return.

* A seller's permit is required to be held by any person engaged in the business of selling tangible personal property in California. Certain lessors must also hold a seller's permit. If you are not required to hold a seller's permit because you make no sales or leases of tangible personal property in California, please enter "Not Applicable".

JCK: 12/16/98, 1/4/99, 1/11/99, 2/1/99, 3/3/99,
4/5/99, 4/30/99, 5/20/99, 6/15/99, 6/23/99

Appendix B

Section 6378 Blanket Exemption Certificate

Please Note: This is a partial exemption from sales and use tax at the rate of 5% effective January 1, 1999. You are not relieved from your obligations for the local and district taxes on this transaction. This partial exemption also does not apply to any tax levied pursuant to section 6051.2 and 6201.2 of the Revenue and Taxation Code, or pursuant to section 35 of article XIII of the California Constitution. This exemption also applies to lease payments made on or after January 1, 1999, notwithstanding the fact that the lease agreement was entered into prior to January 1, 1999. This certificate may ***not*** be used to purchase certain property such as furniture, inventory, meals, vehicles, equipment used to store products or real property.

Seller's Name

Seller's Address
(Street, City, State, Zip Code)

I hereby certify that I am a qualified person primarily engaged in teleproduction or other postproduction services as described in Regulation 1532 and that the property purchased or leased will be used primarily in teleproduction or other postproduction services or to maintain, repair, measure or test any such property. I understand that if such property is used outside the State of California or leased to a non qualified person in the aggregate for more than one half of the one year period following the date of purchase or lease, or if such property is converted for use in a manner not qualifying for the exemption, that I am required by the Sales and Use Tax Law to report and pay the state sales/use tax measured by the sales price of the property to/by me.

PRINT NAME	TITLE	COMPANY NAME
SIGNATURE	DATE	PERMIT NUMBER (if applicable)*
ADDRESS	CITY	STATE, ZIP

Seller must retain a copy of this exemption certificate to support a deduction taken on their return.

* A seller's permit is required to be held by any person engaged in the business of selling tangible personal property in California. Certain lessors must also hold a seller's permit. If you are not required to hold a seller's permit because you make no sales or leases of tangible personal property in California, please enter "Not Applicable."

JCK: 12/16/98, 1/4/99, 1/11/99, 2/1/99, 3/3/99,
4/5/99, 4/30/99, 5/20/99, 6/15/99, 6/23/99

Appendix C

Technical Definitions

DVD (Digital Video Disk) - is a medium for recording compressed audio, visual images and other related data.

Digitizing – Process of converting video containing audio, visual images and other related data into digital format.

Assembly – Combining audio, visual images and other related data into proper sequence and recording to a new edited master videotape pursuant to instructions provided by editor.

Creating 2D Images – Process of enhancing original elements captured through principal photography by creating or manipulating two dimensional images.

Creating 3D Images (CGI) – process of creating three-dimensional images that will ultimately be recorded on film, video or other multimedia format.

Dirt Fixes – Process to electronically "clean up" or "remove" undesirable elements such as dirt and film scratches from visual images.

Digital Video Image Manipulation – This process includes: compositing multiple layers of visual images, changing aspect ratio or scale, flip, defocus, rotate, resize, reposition, crop, color correction, apply special effects such as warping the image, create transitional effects between scenes or shots.

Motion Control Visual Effects Capture – Recording flat art such as pictures and logos and applying movement to the visual image such as pan, scan, zoom. Motion Control Capture could also create tracking points through recording movement of a live subject that will be applied to a computer generated image.

Transcoding – Converting video and audio formats.

Duplication – Process of making film or videotape copies excluding film processing to produce release prints as defined in Regulation 1529 or duplication of video tapes intended for non-broadcast consumer sale or rental.

Automated Dialogue Replacement (ADR) – Recording new dialogue or re-recording dialogue where the production sound is unusable or obscured.

JCK: 12/16/98, 1/4/99, 1/11/99, 2/1/99, 3/3/99,
4/5/99, 4/30/99, 5/20/99, 6/15/99, 6/23/99

Foley – Process of adding to or replacing sound elements that enhance ambient sounds such as footsteps, doors closing, breathing, rustling of clothes, keys jangling in pockets and punches.

Audio Laybacks – Recording the completed audio back to a videotape or film master.

Audio Laydowns – Recording sound from an audio source or video element to another audio element.

Quality Control (QC) – Process by which a film print or videotape is evaluated to make sure it meets technical requirements.

Archiving – Processes involved in preparing and storing film, videotape or other multimedia elements for future use.

Format Transfer Utilizing Compression Standards – To transfer video or audio format utilizing a compression standard to allow for more efficient file size management or file format changes.

Management of Visual or Audio Assets and Related Files Stored as Data – Process of creating database with specified reference points to allow for timely search and retrieval of elements by multiple users through central file servers.

Creation of Data Files Related to a Teleproduction or other Postproduction Service – Data files contain information that is related to the visual and audio information stored on film, video or other multimedia format such as timecode, keycode/flex files, edit decision lists.